Finast

ANNUAL REPORT

FOR THE YEAR ENDING MARCH 25, 1967

FIRST NATIONAL STORES INC.

FIRST NATIONAL STORES, INC.

OFFICERS

ADRIAN O'KEEFFE, *Chairman of the Board*
HILLIARD J. COAN, *President*
JOHN L. DONOVAN, *Vice-President and Treasurer*
JOHN L. MACNEIL, *Vice-President*
EDMUND J. MURPHY, *Vice-President*
WILLIAM A. RYAN, *Secretary and Clerk*
ROBERT B. MCCANN, *Controller*

DIRECTORS

HILLIARD J. COAN
RICHARD C. EVARTS
JOHN L. MACNEIL
EDWARD W. MILLER
EDMUND J. MURPHY
ADRIAN O'KEEFFE
BERNARD M. O'KEEFFE
WILLIAM A. RYAN
EDWARD STALEY

EXECUTIVE COMMITTEE

HILLIARD J. COAN
JOHN L. MACNEIL
EDMUND J. MURPHY
ADRIAN O'KEEFFE

TO OUR SHAREHOLDERS:

Somerville, Massachusetts, May 26, 1967

Sales for the fiscal year ended March 25, 1967 were $641,896,000, a decline of 6.3% from the $684,898,000 of the prior year. Operations for the year resulted in a loss of $976,000 or 60¢ per share (before extraordinary items) as compared with net income of $2,404,000 or $1.47 per share in the preceding year. Extraordinary items relating to the loss on closing of unprofitable stores ($4,000,000) and an adjustment reducing the reserve for obsolescence ($4,280,000) amounted to a net credit of $280,000 or 17¢ per share in the current year.

A substantial portion of the decline in sales is attributable to the large number of stores closed in accordance with the program announced last year. Earnings in the second half of the year were affected by a series of management decisions designed to produce long-range improvement in sales and earnings. Sharp reductions in gross profit margins were made. Certain promotional practices were eliminated and a program stressing basic merchandising was introduced. Changes in organization, plant operations and competitive strategy were initiated. Though costly, these actions were necessary to protect our share of market in the current highly competitive era of food retailing and ultimately to bring about improvement in results.

Dividends amounted to $1.50 per share and consisted of two quarterly payments of fifty cents a share and two of twenty-five cents. A total of $2.50 was paid in dividends in the year ended in March of 1966.

Summary:	*For the Year Ended*	
	March 25, 1967	*March 26, 1966*
Retail store sales	$641,896,000	$684,898,000
Net income (loss) before extraordinary items	$ (976,000)	$ 2,404,000
Extraordinary items, net (see note to financial statements)	$ 280,000	—
Net income (loss)	$ (696,000)	$ 2,404,000
Per share of common stock —		
Income (loss) before extraordinary items	$ (.60)	$ 1.47
Extraordinary items	$ .17	—
Net income (loss)	$ (.43)	$ 1.47
Working capital (current assets less current liabilities)	$ 40,513,000	$ 42,107,000
Fixed assets (less depreciation)	$ 57,833,000	$ 59,017,000
Stockholders' equity (net worth)	$ 92,246,000	$ 96,027,000

Your Company had working capital of $40,513,000 on March 25, 1967 compared with $42,107,000 a year earlier. Current assets at year end were $72,557,000 and current liabilities $32,044,000 representing a ratio of 2.26 to 1 compared with a ratio of 2.78 to 1 in 1966. Expenditures for fixed assets during the year were $4,626,000. Long-term debt was further reduced by the sum of $1,602,000, leaving $4,529,000 outstanding.

At the end of the fiscal year there were five hundred and seventeen stores in operation, four hundred and forty-nine of which were supermarkets. Twelve new stores were opened during the year and sixty-eight were closed, among them forty-nine supermarkets. Fourteen stores were remodeled or enlarged.

In communications to Stockholders in the past year, we reported plans to close and dispose of a number of unprofitable stores which lacked potential for the future. We also stated our growing concern with the effects of competition on our sales and profits and our determination to take the necessary steps to achieve the long-range goal of improved results.

To implement this intent, and as the first step in strengthening management, the Chairman of the Board announced in October the election of Hilliard J. Coan as President of our Company. He has been given the responsibility of formulating and putting into effect the positive programs necessary to accomplish our goal.

Intense activity within our Company has characterized the intervening months. In-depth studies commenced that are leading to changes in concept, structure and operations, some of which have been instituted and are gaining momentum. The changes, consolidations, eliminations, and introductions of various functions, whether related to management structure, accounting, responsibility centered control, or the presentation, quality and pricing of our merchandise, are all incidental to our primary purpose of serving more customers better.

A massive move such as ours involves review of almost every function of the Company. It requires broad understanding and acceptance. We must have the ability to acquaint those outside the Company with our needs and goals — from suppliers, to labor unions, to real estate developers, to customers. On the inside, we must pull together all services, controls, processing, distribution, supervision and store operations into the single comprehensive effort.

In the execution of our plans we have achieved some degree of consolidation in warehousing and transportation. We have brought into the Company capable and experienced people from the outside and have appointed and promoted many able and ambitious young people from within the Company to new and redefined areas of responsibility. We have successfully completed negotiations with several unions and are optimistic that a climate for greater productivity and participation by our people is developing. The store management structure has already been realigned in most of our stores and will be extended as will training and management development programs. Our field staffs, divisional staffs and our corporate staff have been restructured to serve our basic strategy. Store layout and equipment, advertising, display techniques and store signing are under review. Changes have been made in the area of processing of our own products that relate to quality, cost and return on investment. This, too, has called for consolidation of certain functions and elimination of others. All private label products have been subjected to an item-by-item evaluation which provides us with a broader understanding of existing competitive advantages on which we can capitalize.

We are operating stores in many different areas and under many different conditions. Whether the store issues trading stamps or is under our Super Finast division which does not, is secondary to our basic program of merchandising and operations. Rigid quality control policies, fair value in pricing and honesty in presentation are and will be in effect at all times.

The closing and disposition of the group of stores that were mentioned in the Report to Stockholders last year is substantially completed. The remainder of the reserve which has been provided is considered adequate for the estimated future cost of terminating leases or other liabilities arising from this program.

One of the serious problems that confronts us today is a number of stores with strong potential that are operating at critical volume levels. It is of paramount importance that substantial promotional and operational effort be invested to bring volume levels up to points that are consistent with the size of our investment and occupancy costs in these stores. Programs for this purpose are being developed in several special areas within each division at this time.

Our plans call for the opening of 15 new stores and the remodeling of 30 existing stores during the year. Additional renovations may be scheduled for completion within the year. The number of outmoded stores in operation will be further reduced as a result of the modernization program and lease expirations.

The results in the second half of the year reflect the cumulative effect of adverse trends compounded by great emphasis on price competition within our industry in response to consumer reaction to inflationary forces. Building sales may be less costly when all of the tools are in hand, but the need to halt the erosion and establish plateaus to provide a stronger base from which to expand has been vital. As more of the concepts are developed and made effective, as more of our programs become operational, as more of our management team from store level up gain experience in their redefined responsibilities, we will progress.

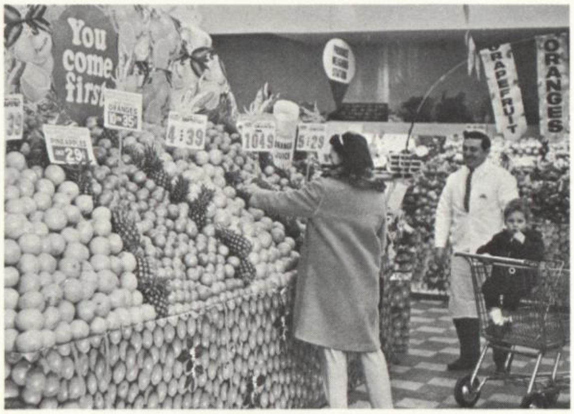
This is a period of maximum effort for every First National employee. We are proud of the response we have had from our people. First National Stores has been the symbol of integrity, quality and value in food retailing. Our reputation and our people provide a solid foundation upon which we will build for the future.

Respectfully submitted,

ADRIAN O'KEEFE
Chairman of the Board

HILLIARD J. COAN
President

At all levels, our Company's interest is to fulfill every customer need and requirement. At left, the President stresses importance of service to a management training group. In photos below: distribution begins with buyer-salesman contact; meat specialists review cutting methods; sparkling displays attract customer interest. At end of shopping tour, courteous service and a friendly smile invite customers to come again.



CONSOLIDATED

ASSETS

	March 25 1967	March 26 1966 (Note 1)
Current assets:		
Cash	$ 14,117,000	$ 18,946,000
Marketable securities, at cost (approximate market)	7,462,000	—
Accounts receivable	3,512,000	4,440,000
Refundable federal income taxes	3,500,000	—
Inventories, at cost (substantially on the basis of last-in, first-out) or market whichever is lower	38,648,000	37,025,000
Prepaid expenses and other current assets	5,318,000	5,362,000
Total current assets	72,557,000	65,773,000
Fixed assets, at cost (excluding fully-depreciated assets):		
Land	8,149,000	8,025,000
Buildings owned	35,072,000	35,044,000
Store fixtures, leasehold improvements, machinery and equipment	82,721,000	90,933,000
Automotive equipment	7,417,000	7,254,000
	133,359,000	141,256,000
Less — Depreciation and obsolescence	75,526,000	82,239,000
	57,833,000	59,017,000
Other assets and deferred charges	1,627,000	1,034,000
	$132,017,000	$125,824,000

L STORES INC.

BALANCE SHEET

LIABILITIES

	March 25 1967	March 26 1966 (Note 1)
Current liabilities:		
Accounts payable	$ 22,915,000	$ 15,174,000
Accrued expenses	8,083,000	7,739,000
Current portion of long-term debt	267,000	267,000
Federal income taxes	779,000	486,000
Total current liabilities	32,044,000	23,666,000
4.70% Notes, due in equal semiannual instalments to 1976	4,529,000	6,131,000
Reserve for estimated losses on closed stores (Note 6)	3,098,000	—
Deferred income taxes (Note 5)	100,000	—
Stockholders' equity:		
Common stock, without par value (Note 2):		
Authorized — 2,000,000 shares		
Issued — 1,655,268 shares	31,977,000	31,977,000
Retained earnings (Note 2)	61,993,000	65,126,000
	93,970,000	97,103,000
Less — Treasury stock, at cost — 46,664 shares in 1967; 23,864 shares in 1966	1,724,000	1,076,000
	92,246,000	96,027,000
Lease commitments (Note 3)		
	$132,017,000	$125,824,000

FIRST NATIONAL STORES INC.

CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

	Year Ended March 25, 1967	Year Ended March 26, 1966 (Note 1)
Income:		
Sales	$641,896,000	$684,898,000
Gain on disposal of fixed assets — net	31,000	258,000
Other income	553,000	469,000
	642,480,000	685,625,000
Costs and expenses:		
Cost of sales, warehousing, transportation and store occupancy expenses	534,150,000	561,220,000
Direct selling (exclusive of store occupancy expenses) publicity, general and administrative expenses	102,265,000	110,655,000
Provision for depreciation (Note 5)	8,960,000	10,468,000
Interest expense	296,000	328,000
Income tax (refund)	(2,215,000)	550,000
	643,456,000	683,221,000
Income (loss) before extraordinary items	(976,000)	2,404,000
Extraordinary items (Note 6):		
Provision for loss on disposition of closed stores, net of $3,800,000 estimated income tax benefits	(4,000,000)	—
Portion of reserve for obsolescence no longer required (not deducted for income tax purposes during years in which provided)	4,280,000	—
	280,000	—
Net income (loss)	(696,000)	2,404,000
Retained earnings at beginning of year	65,126,000	66,809,000
Cash dividends paid — $1.50 per share in 1967; $2.50 per share in 1966	(2,437,000)	(4,087,000)
	$ 61,993,000	$ 65,126,000
Per share of common stock —		
Income (loss) before extraordinary items	$(.60)	$1.47
Extraordinary items, net of tax	.17	—
Net income (loss)	$(.43)	$1.47

CONSOLIDATED STATEMENT OF SOURCE AND USE OF FUNDS

YEAR ENDED MARCH 25, 1967

Source of funds:	
Net loss before extraordinary items	$ (976,000)
Depreciation of fixed assets	8,960,000
Excess of net proceeds and non-cash items, $1,187,000, over $902,000 net costs incurred on closed stores	285,000
Deferred income taxes	100,000
Reduction in working capital	1,594,000
	$9,963,000
Use of funds:	
Net additions to fixed assets	$4,626,000
Cash dividends paid	2,437,000
Reduction in long-term debt	1,602,000
Acquisitions of treasury stock	648,000
Increase in other assets	593,000
Other	57,000
	$9,963,000

FIRST NATIONAL STORES INC.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 — Principles of Consolidation and Restatement of Prior Year Financial Statements

The accompanying consolidated financial statements include the accounts of the Company and all of its wholly-owned subsidiaries. The financial statements for the year ended March 26, 1966 have been restated on a consolidated basis. In addition, prepaid expenses in those statements have been reclassified as current assets. The consolidation of wholly-owned subsidiaries had no material effect on previously published financial statements.

NOTE 2 — Common Stock and Retained Earnings

As of March 26, 1966 options to purchase 33,700 shares of the Company's common stock were held by certain officers and key employees of the Company and its subsidiaries. During the year an option for 7,500 shares was granted and options for 2,100 shares terminated. At March 25, 1967 options for 39,100 shares were outstanding at prices ranging from $27.125 to $64.25 per share, of which options for 31,450 shares were then exercisable. The options become exercisable in equal annual instalments over a four-year period beginning one year after the date granted. Under the terms of the plan, as amended, additional options for 35,900 shares may be granted at prices no less than the fair market value of the common stock at the date of grant and such options expire not more than five years after the date granted.

At March 25, 1967 the portion of earnings employed in the business available for the payment of cash dividends and acquisition of the Company's common stock was approximately $15,500,000 as calculated in accordance with the terms of the loan agreement covering the long-term debt.

NOTE 3 — Lease Commitments

At March 25, 1967, the Company was committed under 460 leases covering stores and other properties. The minimum annual rentals under these leases amount to approximately $11,200,000 exclusive of real estate taxes and other expenses or additional rentals based on percentage of sales. Of the minimum annual rental commitment, approximately 49% related to leases expiring within 10 years and approximately 84% to leases expiring within 15 years. Leases on certain closed stores have not been included in the above totals (see Note 6).

NOTE 4 — Pensions

Since 1947 the Company has maintained a trusteed noncontributory pension plan. As a result of union contract negotiations during 1967, coverage of a substantial number of employees was transferred to union pension plans to which the Company will make contributions as agreed to in union negotiations. It has been determined that no contribution to the Company plan will be required for several years as a result of the amortization of actuarial gains resulting from a change in the interest assumption and transfer of employees plus a portion of the unrealized appreciation in the current fund. Total pension costs charged to earnings in 1967 (contributions to union plans) was $667,000 and 1966 (contributions to Company and union plans) $981,000.

NOTE 5 — Depreciation

In 1967 the Company changed from the use of accelerated methods of computing depreciation to the straight-line method with respect to depreciation on fixed assets acquired during the current fiscal year. Accelerated depreciation will be continued for tax purposes. The resulting reduction in federal income taxes has been deferred. As a result of this change in method the net loss for the year was decreased by less than $100,000. There is no change in the method of computing depreciation on assets acquired prior to March 26, 1966.

NOTE 6 — Extraordinary Items

The previously announced program of closing stores which lacked potential for future profitability has been substantially completed. A reserve has been provided for the estimated losses on lease terminations and write-downs of fixtures in stores closed or to be closed by an extraordinary charge to earnings for the year ended March 25, 1967. The costs incurred in 1967 have been charged to this reserve and the balance at March 25, 1967 is considered adequate for the estimated future costs to be incurred.

In conjunction with the aforementioned program, a study was made of the adequacy of the reserve for obsolescence of owned stores which reserve had been provided for over a period of several years. In recent years most of the Company's new stores have been leased rather than owned resulting in a decline in the number of owned stores operated in relationship to total stores operated. This factor plus the continuing charges for normal depreciation has greatly diminished the exposure to losses from obsolescence of owned stores and the portion of the reserve which is no longer required has been reversed as an extraordinary credit.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of First National Stores Inc.

In our opinion, the accompanying consolidated balance sheet, the consolidated statement of income and retained earnings and the consolidated statement of source and use of funds present fairly the financial position of First National Stores Inc. and consolidated subsidiaries at March 25, 1967 and the results of their operations and the supplementary information on funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Our examination of these statements was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

PRICE WATERHOUSE & CO.

Boston, Massachusetts
May 22, 1967

FIRST NATIONAL STORES INC.

TEN-YEAR REVIEW (IN THOUSANDS OF DOLLARS EXCEPT FOR PER SHARE AMOUNTS)

	1967[1]	1966[1]	1965	1964	1963	1962	1961	1960	1959	1958
RESULTS OF OPERATIONS										
Retail store sales	$ 641,896	$ 684,898	$ 706,670	$ 723,402	$ 746,089	$ 711,304	$ 536,486	$ 525,351	$ 531,521	$ 521,495
Net earnings (loss)[2]	(976)	2,404	5,560	7,103	7,788	8,172	7,859	8,223	8,649	8,799
Net earnings (loss) per share[2]	(.60)	1.47	3.39	4.33	4.73	4.98	4.80	5.02	5.28	5.37
Cash dividends per share	1.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50
FINANCIAL POSITION										
Current assets	72,557	65,773	59,985	61,502	65,466	68,802	52,100	44,737	43,665	45,728
Current liabilities	32,044	23,666	25,020	31,604	36,663	46,017	29,997	24,226	25,258	28,202
Net working capital	40,513	42,107	34,965	29,898	28,803	22,785	22,103	20,511	18,407	17,526
Ratio of current assets to current liabilities	2.26	2.78	2.40	1.95	1.79	1.50	1.74	1.85	1.73	1.62
Fixed assets, net	57,833	59,017	62,916	66,259	66,312	68,138	58,061	57,172	55,411	52,579
Total assets	132,017	125,824	129,592	134,907	138,994	145,596	115,040	105,503	102,405	101,210
Long term debt	4,529	6,131	6,665	7,733	9,730	10,250	—	—	—	—
Stockholders' equity	92,246	96,027	97,907	95,570	92,581	89,329	85,043	81,277	77,147	72,590
OTHER DATA										
Capital expenditures — net	4,626	6,311	7,669	11,341	9,967	20,982	9,767	11,239	11,636	14,763
Provision for depreciation	8,960	10,468	11,367	11,606	12,354	10,533	9,517	9,411	8,912	8,175
Shares of common stock outstanding (at end of year)	1,608,604	1,631,404	1,638,904	1,639,204	1,639,598	1,647,670	1,637,154	1,637,154	1,637,154	1,637,154
Number of stores (at end of year)	517	573	600	601	610	632	516	534	543	575

[1] Consolidated; parent company only shown for prior years. See Note 1 to financial statements.

[2] Before extraordinary items.

TRANSFER AGENTS: THE FIRST NATIONAL BANK OF BOSTON, BOSTON, MASS.
CHEMICAL BANK NEW YORK TRUST COMPANY, NEW YORK, N.Y.

REGISTRARS: STATE STREET BANK AND TRUST CO., BOSTON, MASS.
BANKERS TRUST CO., NEW YORK, N.Y.